Federal Communications Commission

Washington, D.C.

CHAIRMAN

July 17, 2002

VIA FACSIMILE TRANSMITTAL
AND HAND-DELIVERY

The Honorable Michael G. Oxley
Chairman
Committee on Financial Services
U. S. House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairman Oxley:

This letter responds to your correspondence of July 11, 2002, regarding WorldCom's recent disclosure of financial accounting inaccuracies and the Committee's general inquiry of the Federal Communications Commission's historic role relating to accounting review activities.

At the outset, let me stress that I am deeply troubled by WorldCom's disclosures and am concerned about the long-term, far-reaching repercussions on the general health of the telecommunications marketplace and on the impact of the nation's telecommunications infrastructure upon which immeasurable numbers of customers and other critical end-users depend. I assure you that the Commission has already taken action to protect the public interest in general and WorldCom's customers in particular, and will continue to take such actions as are necessary and consistent with our authority under the Communications Act.

Over the last three weeks, we have taken steps to ensure that the Commission has and continues to receive the most up-to-date information about WorldCom's developing situation. I met with John W. Sidgmore, Chief Executive Officer of WorldCom, to hear about the company's financial situation and ability to maintain service quality first-hand and, since that initial meeting, have engaged in regular communications with Mr. Sidgmore and will continue to do so for the foreseeable future.

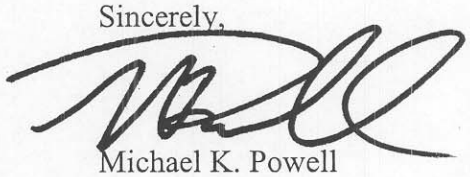
Within three days of WorldCom's first announcement that it had discovered financial accounting irregularities, I met with representatives of the telephone industry, financial analysts and debt-rating agencies to gain an understanding of WorldCom's immediate situation and also discuss how these developments impact the telecommunications industry. Additionally, I have participated actively in interagency discussions to ensure a broad understanding of WorldCom's impact on the government's use of telecommunications and its impact on the industry, as a whole. I will continue to keep these lines of communication open and active for as long as the current situation persists. Finally, as you noted in your correspondence, I was appointed to serve on the new inter-agency Corporate Fraud Task Force to offer the Commission's expertise to

assist in efforts to investigate and prosecute significant financial crimes and restore credibility to and confidence in the market.

The Commission's staff has worked with WorldCom executives and conducted its own independent research so that our information regarding the extent of WorldCom's operations and its customer base are up-to-date. The Commission's staff has also spoken with anxious consumers, other carriers, and other government agencies, both to provide them with information the Commission has about the current situation and our processes, and also add to our own understanding of the scope of the problem. We have been in extensive consultation with state public utility commissions to explore coordinated responses to carrier bankruptcies. These state public utility commissions also have responsibility to ensure continuity of local and intrastate services and may be, in some cases, better placed to act quickly to prevent a catastrophic loss of service. In short, the Commission is gathering the information and developing the tools we need to deal with whatever situation may arise in coming weeks.

We at the Commission appreciate the opportunity to respond to the Committee's request, and trust you and your colleagues will find our responses useful and informative.

Sincerely,



Michael K. Powell

1. Section 218 of the Communications Act provides, "The Commission may inquire into the management of the business of all carriers subject to this Act, and shall keep itself informed as to the manner and method in which the same is conducted. In that regard:

   What is the mechanism utilized by the FCC to "inquire into the management" of communications common carriers? What specific regulations have been issued to satisfy this part of the statute?

   Inquiries appear to be permissive under the statute, but the law requires that the FCC "keep itself informed." Has the FCC waived this requirement? Did the FCC grant a forbearance petition? The law appears to be quite specific on its face. What exactly is done on a routine, continuing basis to fulfill these requirements?

   Response:

   Section 218 states in full that

   > The Commission may inquire into the management of the business of all carriers subject to this chapter, and shall keep itself informed as to the manner and method in which the same is conducted and as to technical developments and improvements in wire and radio communication and radio transmission of energy to the end that the benefits of new inventions and developments may be made available to the people of the United States. The Commission may obtain from such carriers and from persons directly or indirectly controlling or controlled by, or under direct or indirect common control with, such carriers full and complete information necessary to enable the Commission to perform the duties and carry out the objects for which it was created.

   Section 218 is focused on ensuring that the Commission has information related to technical and management issues necessary for fulfillment of its statutory duties. The Commission regularly relies on its authority under section 218 to conduct investigations on its own motion into possible violations by common carriers of the Communications Act and Commission rules and orders. With the growth of competition and participation in the telecommunications marketplace, however, the Commission does not and cannot routinely or systematically "inquire into the management" of the thousands of communications common carriers that compete in today's market. It has not done so for decades. The language the Committee asks about in section 218 came from the Interstate Commerce Act and was adopted as part of the Communications Act in 1934, a time when the Commission's common carrier regulatory responsibilities were limited to a handful of companies. While the Commission has never issued regulations for the purpose of directly implementing section 218 of the Act, it has always kept itself fully informed about the businesses under its jurisdiction.

Section 218 is an important source of authority for many of the regulations that the Commission has adopted over the years to implement other, more specific statutory mandates. For example, the provision allowing us to inquire into management of a carrier's business supports the rules governing interconnection (47 CFR Part 51), numbering (47 CFR Part 52), Bell Operating Company separate affiliates (47 CFR Part 53), extension of lines (47 CFR Part 63), prescription of rates of return for certain carriers (47 CFR Part 65) and the access charge rules (47 CFR Part 69). The authority contained in section 218 has ensured that carriers cannot challenge or avoid the rules we have adopted on the grounds that those requirements touch on the management of their business.

The Commission has neither waived nor forborne from its responsibility to keep itself informed as to ways in which common carriers conduct their business. Expert staff in the Commission's Office of Plans and Policy and the Wireline Communications Bureau regularly monitor industry trends and developments through review and analysis of information from a wide variety of publicly-available sources. Furthermore, professional staff in every part of the Commission meet regularly with carriers, customers, consumers, competitors, equipment manufacturers, engineers and other technical experts, academic economists, and members of the financial community in order to stay abreast of developments in the increasingly complex field of telecommunications.

2. Section 219(a) of the Communications Act authorizes the Commission "to require annual reports from all carriers subject to this Act. That section also requires carriers to submit information related to their financial structure and activities. Does the Commission enforce this statute with regard to "all carriers", as the statute envisions, or is the FCC allowed to act selectively?

   Please provide citations to the published FCC rules implementing Section 219 and exempting "nondominant" carriers including WorldCom from these financial disclosure requirements.

   Response:

   Section 219(a) provides the Commission with broad authority to inquire about and receive information about the financial and corporate structure of "all carriers subject" to the Communications Act. In prescribing rules, the Commission has relied upon Section 219 and other sections of the Communications Act as authority to establish the Uniform System of Accounts (Part 32) and the several reports addressed in Part 43 of our rules – Reports of Communication Common Carriers and Certain Affiliates.

   While section 219 allows the Commission to require annual reporting from all carriers subject to the Act, it also states that "except as otherwise required by the Commission," specified information shall be included in those reports. *See* 47 U.S.C. § 219. The Commission has taken advantage of both the broad authority and the flexibility granted to it under this section to create reporting requirements that are suited to our regulatory needs. Thus, large incumbent local exchange carriers file extensive annual reports, while nondominant carriers file much less information.

   The current scope of the annual reporting requirement was adopted in 1997 and is delineated in section 43.21 of our rules. Sections 43.21(b) and (c) require larger nondominant carriers to file copies of their SEC Form 10-K and an annual letter stating operating revenues and total plant value. Each of the other, more detailed annual reporting requirements in sections 43.21 (d) - (k) is made applicable only to specified incumbent local exchange carriers; thus those requirements are not applicable to nondominant carriers such as Worldcom.

3. Over the years, the Commission has required merging common carriers to submit to an array of information to the Commission. The carriers maintain that this information duplicates material which is submitted to the Justice Department's Antitrust Division and the Federal Trade Commission's Bureau of Competition under the Hart-Scott-Rodino Pre-Merger notification Act.

   How many of WorldCom's mergers and acquisitions over the years have been reviewed by the FCC? Please describe the FCC's practice regarding these transactions, to include how long, on average, it has taken to review the various materials.

   When WorldCom acquired MCI in 1999, critics, to include the Communications Workers of America and the AFL-CIO, reportedly filed comments with the FCC suggesting that WorldCom's finances were at that time questionable. Did the FCC take any action in response to those and any other similar submissions?

   Response:

   WorldCom has filed applications regarding two mergers with the Commission. Specifically, on October 1, 1997, WorldCom filed a transfer of control application with the Commission in conjunction with its initial tender offer for MCI. On November 21, 1997, following WorldCom and MCI's November 8, 1997 merger agreement, the companies jointly amended the October 1, 1997 application for transfer of control of MCI license and authorizations to WorldCom. The Commission issued an order on September 14, 1998 granting the amended application. Thus, the Commission's review of the WorldCom-MCI merger transaction took approximately one year to complete.

   On November 17, 1999, MCI WorldCom and Sprint filed a joint application with the Commission for approval to transfer control of licenses and authorizations from Sprint to MCI WorldCom in connection with their proposed merger. On July 13, 2000, the applicants withdrew their application from Commission consideration. The Commission subsequently terminated its review of this transaction.

   As to the Commission's practice in reviewing merger transactions, pursuant to sections 214(a) and 310(d) of the Communications Act, of the 1934, as amended, the Commission must determine whether merger applicants have demonstrated that their transaction will serve the "public interest." The Commission begins its inquiry by placing the application for transfer of control on "Public Notice" to receive comment from interested parties. Once the record is closed, the Commission begins to analyze the record and determine which relevant product and geographic markets will be affected by the transaction. In most cases, as in the WorldCom transactions, it is necessary for the Commission to seek additional information from the applicants. The record in large merger proceedings such as WorldCom's can be quite

voluminous. Once the Commission has the information it needs to determine whether the transfer of control is in the "public interest" it renders a decision.

As you point out, in the context of the WorldCom-MCI merger proceeding, CWA and the AFL-CIO filed comments stating that the merger was contrary to the public interest. These parties believed that, because of the premium price that WorldCom agreed to purchase MCI, it would be under financial pressure to pursue only high-margin business customers and abandon the pursuit of residential customers. In short, these parties contended that the proposed merger savings cited by the applicants would likely be realized through a withdrawal of service to the residential market. *These allegations did not, however, argue that the Commission should deny the merger because of the kind of improprieties that recently came to light.*

The Commission did not ignore the allegations CWA and the AFL-CIO did make, and in fact obtained written commitments from WorldCom and MCI to address them. The Chairmen of WorldCom and MCI sent letters to the Commission committing to continue serving the residential market and even to augment their efforts in this market by offering consumers a package of services including local, long distance, wireless, international, and Internet. These letters are attached hereto at Tab 1. As promised, the company has continued to serve residential markets since the merger.

4. Please explain briefly the "standard operating procedures" which the FCC has in place to coordinate its responsibilities and activities with the Securities and Exchange Commission (SEC)?

Response:

The Commission does not have the jurisdiction to enforce securities and banking laws, and thus has not historically had formal coordination procedures or standard operating procedures specific to the Securities and Exchange Commission (SEC) but has instead coordinated with other federal agencies, such as the SEC on an as needed basis. In light of recent events and in conjunction with my role on the President's Corporate Fraud Task Force, I have directed my staff to draft a possible Memorandum of Understanding with the SEC to facilitate information sharing.

5. Please explain briefly the "standard operating procedures" which the FCC has in place to coordinate its responsibilities and activities with the Antitrust Division of the Department of Justice?

Response:

The Commission regularly coordinates with the Antitrust Division of the U.S. Department of Justice on a wide variety of matters involving shared responsibility and common concerns. In addition to the close coordination of litigation matters with antitrust implications, the Commission has frequent and regular contacts regarding the review of section 271 applications and major communications mergers.

As you know, section 271(d)(2)(A) of the Communications Act requires that the Commission "shall consult with the Attorney General" and "shall give substantial weight to the Attorney General's evaluation" in any application by a Bell Operating Company for entry into the interLATA services market. The Attorney General designated the Antitrust Division of the Department of Justice as the division responsible for fulfilling the Attorney General's obligations under section 271 of the Act.

On March 23, 2001, to facilitate this consultative process, the Commission's Common Carrier Bureau issued a Public Notice revising the procedures governing applications filed pursuant to section 271. *See* Updated Filing Requirements for Bell Operating Company Applications Under Section 271 of the Communications Act, Public Notice, DA 01-734 (rel. Mar. 23, 2001). Pursuant to this Public Notice, the Department of Justice's written consultation generally must be filed with the Commission not later than approximately 35 days after the issuance of the Commission's notice that it has received a section 271 application. Parties to these proceedings must file with the Commission any materials that they file with the Department of Justice during the pendency of the proceeding.

The Commission also closely coordinates with the Antitrust Division on the review of major communications transactions, such as mergers. The Antitrust Division reviews the impact of such transactions on competition under the Clayton Act, as amended by the Hart-Scott-Rodino (H-S-R) Act.

Applicants generally grant a limited waiver of the confidentiality protections imposed by the H-S-R Act to allow Commission staff to review and discuss documents produced to the Antitrust Division. Any documents the Commission identifies as important to our proceeding are then requested independently in that proceeding. This reduces the need for duplicative broad requests for documents related to the competitive impact of the proposed transaction. In addition, the staffs of the Commission and of the Antitrust Division have frequent contacts and discussions about the general analysis of competitive effects.

6. Please explain the "standard operating procedures" which the FCC has in place to coordinate its responsibilities and activities with the Bureau of Competition of the Federal Trade Commission?

Response:

The Commission and the FTC work closely with respect to their common interest in protecting consumers of telecommunications services. The two staffs communicate regularly and have developed joint documents such as the March 2000 Policy Statement for the Advertising of Dial-Around and Other Long-Distance Services to Consumers.

The Commission and FTC also regularly coordinate with each other on competition issues. With regard to mergers, the Commission routinely works with the Bureau of Competition to review transaction documents. As with DOJ antitrust documents, applicants generally grant a limited waiver of the confidentiality protections imposed by the H-S-R Act to allow Commission staff to review and discuss documents produced to the Bureau of Competition.

7. The National Association of Securities Dealers and other securities exchanges have "self regulatory" responsibilities. The law envisions the SEC as regulating these "self-regulating organizations" (SROs).

What procedures has the FCC established to interact with these SROs? Is there an established point of contact or a standardized way in which information is exchanged?

If there is no standard operating procedure by which the FCC interacts and coordinates with the SEC, and if there is also none by which the FCC communicates with the SROs, do you think that there should be? How else would you and your fellow Commissioners keep yourselves informed otherwise?

Response:

The Commission routinely interacts with many private sector trade associations interested in and affected by the activities of the Commission. The Commission does not, however, have established procedures to interact with the National Association of Securities Dealers and other securities exchanges with "self-regulatory" responsibilities.

The Commission expects to continue to have regular contacts with other federal agencies, including the SEC, to ensure clear and timely communications and to maintain an ongoing dialog on key issues. We will of course continue to evaluate whether there are ways to enhance our coordination efforts. In this regard, as noted above in response to question 4, I have directed my staff to draft a possible agreement with the SEC to facilitate information sharing.

8. The FCC's Wireline Competition Bureau has an Industry Analysis Division that collects and regularly publishes reports on common carrier industry developments in what is presumably an attempt to keep track of whether FCC policies are working. It is our understanding that you have also taken action to establish similar units in all of the FCC's other operating bureaus.

   How much corporate financial information has the Industry Analysis Division been collecting over the years on the "nondominant" wireline carriers?

   Has that information been made available to the Commissioners and their staff?

   Has that information been made available to the public?

   Do you believe that information such as this should be collected?

   Response:

   The Wireline Competition Bureau's Industry Analysis and Technology Division (formerly the Common Carrier Bureau's Industry Analysis Division) is the Bureau's information and technology division. As the Committee's inquiry indicates, one of the division's main responsibilities is the compilation, analysis and production of reports on the common carrier industry. The division also provides economic and technical analyses of telecommunications markets for the Bureau and the Commission in order to address complex issues flowing from technical convergence and competitive markets, and to monitor the effectiveness of Commission policies.

   Historically, the Commission has tailored its formal reporting requirements for common carriers depending on whether a given carrier possesses market power. Large, dominant carriers like the regional Bell Operating Companies (RBOCs) are subject to more extensive financial reporting requirements, while nondominant carriers report very limited information. This reflects sound economic thinking regarding how different types of markets operate and the ways that consumers are differently affected by the actions of market players depending on whether particular markets are competitive.

   In its provision of telecommunications services, WorldCom (and all other long distance companies) are nondominant carriers. Currently, nondominant wireline carriers submit a limited amount of corporate financial information pursuant to section 43.21 of the Commission's rules regarding annual reports of carriers and certain affiliates. The Commission receives copies of Securities and Exchange Commission Form 10-K, pursuant to section 43.21(b), from each company, not itself a communication common carrier, that directly or indirectly controls any communication common carrier that has annual operating revenues equal to or above a certain indexed revenue threshold, currently $119 million, as defined in section 32.9000 of the Commission's rules. The division also receives, pursuant to section 43.21(c), a letter from each miscellaneous common carrier above the indexed revenue

threshold containing the carrier's annual operating revenues for that year and the value of its total communication plant at the end of that year. The section 43.21(c) information and selected information from the SEC reports is made widely available via Commission reports publicly released and made accessible on our Internet web site. (*See e.g.*, Industry Analysis Division, Common Carrier Bureau, *Statistics of Communications Common Carriers* (September 2001) available at www.fcc.gov/web/stats.) All of this information is available to the Commissioners and their staff. And, except for certain information that the carriers regard as proprietary, all of it is available to the general public as well.

9. Earlier this year, Global Crossing, one of the largest international communications carriers collapsed and filed for bankruptcy protection. As a result of that occurrence, there were a number of reports about questionable internal corporate transactions.

What did the FCC International Bureau do as a result of this massive business failure, which was one of the largest in the history of the United States? Did the Bureau undertake a post-mortem review: Did it undertake a formal or an informal "risk assessment"? Did the Bureau take any action at all?

What initiatives did other units of the FCC take regarding Global Crossing collapse?

How often has the FCC or its staff coordinated with the SEC, Department of Justice, or SROs regarding the ongoing investigation of the Global Crossing collapse?

Response:

The Commission shares the Committee's concern that Global Crossing's bankruptcy and the initiation of investigations into its activities were significant and serious events in the telecommunications industry. In any situation where a carrier files for bankruptcy, this Commission's first priority is to protect consumers by ensuring that the carrier observes its obligations under section 214 to obtain the Commission's prior approval to transfers of control or any discontinuance of service. As Global Crossing's situation has developed, the Commission has acted consistently with this priority.

Specific to the Committee's questions regarding actions by the Commission's International Bureau, it has acted to review applications filed with the Commission associated with Global Crossing's bankruptcy proceedings. The Bureau has issued Public Notices regarding the notifications of Global Crossing, Ltd. and its subsidiaries of *pro forma* assignments of cable landing licenses and Section 214 authorizations into debtor in possession status. *See* Public Notice, DA No. 02-1448, Report No. TEL-00543 (rel. Jun. 20, 2002); Public Notice, DA No. 02-1653, Report No. TEL-00548 (rel. Jul. 11, 2002). Additionally, Global Crossing's subsidiary Global Crossing Telecommunications, Inc., which has approximately a 0.4256 percent share in the Japan-U.S. cable system, has filed an application to relinquish its interest in the Japan-U.S. cable landing license. Nothing further has been filed by Global Crossing. The Bureau also monitors availability of international transport capacity to ensure that sufficient capacity is available to customers under competitive market conditions. The information in reports filed with the Commission and a recently completed proceeding involving the competitiveness of the international transport market show that sufficient capacity will continue to be available to meet demand.

With regard to the Committee's other questions regarding actions by other bureaus and coordination with other agencies, and our general efforts, immediately after Global Crossing filed for bankruptcy protection, principals of Global Crossing and its

regulatory counsel met with representatives from the staff from the Office of the General Counsel and the above bureaus to discuss the circumstances of its filing, and to address any regulatory concerns that the Commission might have. The Commission has thus discussed with Global Crossing how best to coordinate applications for transfers of control, in the event Global Crossing were purchased or a restructuring made such an application necessary, and handled specific applications as described above. Global Crossing provided the Commission with assurances with respect to its ability to continue to provide service over the expected period of its Chapter 11 case, and to otherwise comply with the Commission's regulations. Representatives of the Commission's Wireline Competition Bureau and Office of General Counsel have also discussed issues concerning integrity of service with concerned customers of Global Crossing.

In terms of coordination with other government agencies, the Office of the General Counsel is coordinating with the Department of Justice, specifically the United States Attorney's Office for the Southern District of New York, to appear before the bankruptcy court and ensure that the Commission continues to receive information regarding developments in this case. Aside from the Commission's efforts with the Department of Justice to ensure that consumers receive the benefit of the protections afforded by the Communications Act, we have not been requested to assist the investigating agencies and have not otherwise coordinated with the Department, the SEC or any SROs regarding any ongoing investigations they may be conducting into Global Crossing's affairs.

10. The FCC recently shifted its Accounting and Audits Division from the old Common Carrier Bureau to the new Enforcement Bureau. It seems unusual that in the midst of scandals surrounding "creative accounting" for the FCC to seek to end or at least diminish its own accounting review operations, but there was allegedly some rationale for doing so that was presented to the House and Senate Appropriations Committees. Please provide the rationale for this request as was provided to the House and Senate Committees.

Response:

Staff and functions from the Accounting Safeguards Division (formerly known as the Accounting and Audits Division) were shifted to various divisions within both the Wireline Competition Bureau and the Enforcement Bureau so as to strengthen the accounting review and audit operations of the agency. Specifically, the integration of the audit functions into the Enforcement Bureau was to enhance the efficiency of the Commission's investigatory function. The integration of the accountants and other Accounting Safeguards Division staff into the reconfigured divisions within the Wireline Competition Bureau was to improve the economic and financial analysis of the Bureau as well as to consolidate all cost review functions in one division in the Bureau. I would note, however, that our reorganization long preceded the current scandals surrounding "creative accounting." Indeed, the Commission adopted the reorganization and sent it to Congress in January, 2002, and our appropriators approved that reorganization on March 4, 2002. Attached hereto at Tab 2 are briefing materials provided to congressional staff during meetings regarding the reform effort, including the reorganization of the agency.

11. On June 6th [2000], the FCC released an order adopting a consent decree with WorldCom that terminated an 8investigaiton in "slamming" of consumers preferred carriers by WorldCom. In the agreement, WorldCom later agreed to structure its telemarketing and other business practices to protect consumers against "slamming" and paid a $3.5 million "voluntary contribution" to the U.S. Treasury.

    Please provide a copy of the consent decree and a summary of all enforcement actions taken since 1995 against WorldCom, to include consent decrees, for its business practices.

    Response:

    Attached hereto at Tab 3 is a copy of the order and associated consent decree as requested. In addition, attached hereto at Tab 4 is a chart showing enforcement actions against WorldCom or its subsidiaries since 1995.